



# Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

## Miller and Doerflinger on budget crisis

The state of Oklahoma is facing the most dire budget picture in more than 30 years with an almost 20 percent reduction in estimated revenue.

As negotiators for the House, Senate and governor work to reach agreement on a balanced budget that doesn't decimate core state services, Treasurer Ken Miller sat down with Finance Secretary Preston Doerflinger to talk about potential solutions.

**MILLER:** Preston, you and I both started our service in the Executive branch at the same time – I coming from the appropriations and budget position

in the state House, and you from the Tulsa city auditor's position following a successful business venture.

With the Great Recession in the rear-view mirror, Oklahoma had several good expansion years and I know we both hoped the worst was behind us. Now, the state faces a \$1.3 billion budget hole, and the governor is proposing bold budget reforms.

As Secretary of Finance, you have played a large role in crafting these proposals, which require a lot of heavy lifting for you both. Why the aggressive

agenda, and what is its likelihood of adoption?

**DOERFLINGER:** This is the biggest budget challenge of the past decade because, unlike last time, there is no federal stimulus money to use as a crutch. Closing enough of the hole to pass a responsible budget is a huge lift, but it can be done. The governor has shown multiple responsible paths that can be taken to close this hole and put us on better fiscal footing going forward without punitive tax increases or unsound budget gimmicks.

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- **Treasurer's commentary: It's the revenue, stupid!**
- **Continued slide seen in March Gross Receipts to the Treasury**
- **Gross Receipts and General Revenue compared**
- **State unemployment rises to 4.4 percent in March**

#### Editor

Tim Allen, Deputy Treasurer for Communications and Program Administration

## 60 Minutes exposes life insurance practices

In a story entitled "Not Paid," CBS News' *60 Minutes* exposed practices by life insurance companies of not reporting unclaimed policy proceeds.

The story by CBS News Correspondent Lesley Stahl aired April 17 and included an interview with Treasurer Ken Miller.

For the past three years, Miller has opposed legislation backed by Chicago-based Kemper Insurance and its Oklahoma affiliate Reserve National Insurance to create a special exemption to the state's unclaimed property program.

Stahl's story begins, "When you take out a life insurance policy, you pay premiums in the expectation that when you die your spouse or your children will receive the benefit. But audits of the nation's leading insurance companies have uncovered a systematic, industry-wide practice of not paying significant numbers of beneficiaries."

Video of the full story and a transcript can be viewed [here](#).

Information on the nation's unclaimed property programs and how to discover if you have any money is linked [here](#).



## Treasurer's Commentary

By Ken Miller, Ph.D.

### It's the revenue, stupid!

This month's Gross Receipts to the Treasury are the lowest April total in four years and mark a 12<sup>th</sup> consecutive month of falling collections. On an annualized basis, Gross Receipts to the Treasury are the lowest since June 2013 and all major revenue streams are smaller than one year ago.

The direct and indirect effects of contraction in our state's anchor industry are, of course, driving these numbers. Monthly collections from oil and natural gas production taxes have been lower than the same month of the prior year for 16 consecutive months, including gross production collections of less than \$21 million in April – the lowest monthly total in more than a decade.

Even so, some politicians are reticent to admit by word or deed the state has a revenue problem, instead defaulting to inaction and the tried and true spending problem rhetoric. For those who conveniently posture our current crisis is rooted in spending, I have breaking news: It's the revenue, stupid!

Yes, spending inefficiencies exist and should be addressed, but the ones still on the table are politically difficult and the will to address them currently lacking – sentencing reform a laudable exception. Yes, the income

tax cut trigger was flawed, but a “roll back” isn't possible without a willing supermajority. Regardless, addressing both isn't enough to correct the short-term problem – a \$1.3 billion dollar budget gap – or the long-term problem – a structurally deficient budget.

The long and short of it is Oklahoma needs more recurring revenue. This is a common sense conclusion evidenced by years of general appropriation bills that included hundreds of millions in nonrecurring revenue, in good times and bad, that falsely propped up budgets and exacerbated the current problem.

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**“The long and short of it is Oklahoma needs more recurring revenue.”**

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Governor Fallin has proposed several ways to correct this deficit. Some proposals address the current budget shortfall, like redirecting cash by bonding infrastructure. Other proposals address structural problems, such as increasing the cigarette tax, reining in sales tax exemptions, and modernizing the tax code. No doubt there are other



solutions, including eliminating overly generous or unnecessary tax incentives.

Additionally, Congress needs to pass, and our delegation needs to support, the Marketplace Fairness Act to allow states to collect taxes on Internet sales from laws that are already on the books. Click-and-order should not have an advantage over brick-and-mortar.

To date, Fallin's proposals have not been embraced by the Legislature, nor have cuts to the magnitude necessary to balance the budget. Unpopular and politically dangerous decisions lay ahead, a task not usually embraced by those whose career longevity is determined at the ballot box. Unfortunately, fiduciary duty now requires it.

With Oklahoma's per capita income near the median but spending on three of the four core functions of

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## Commentary

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state government in the bottom 10 on a cost-of-living adjusted basis – public safety higher only because of incarceration rates – budget writers cannot cut their way out of this problem without inflicting significant harm on Oklahoma’s future. Our people and businesses need a tax system that retains the profit incentive to propel the economy and incomes, yet also one that properly educates,

protects and transports a healthy populace and workforce.

Of course, we Oklahomans have seen the cycle before and emerged each time better prepared for the next. Following the 1980s bust, lessons were learned and a rainy day fund and expenditure limitations were implemented. After the Great Recession, the cap on the rainy day

fund was raised and pension reforms began.

In times such as these, statesmen who put the needs of their constituents above elections and aspirations will step up. Hopefully, they will form a governing majority. Lessons will again be learned, deficits will be corrected, and Oklahoma will emerge further down the path to greater prosperity.

## Budget

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#### Nothing but cuts?

**MILLER:** I appreciate the leadership on this issue. Clearly, Oklahoma has a recurring revenue problem that must be addressed. Perhaps, presenting scenarios of what balancing the budget on cuts alone would look like would be helpful.

**DOERFLINGER:** Sure, cuts of up to 25 percent at most agencies would be necessary without additional revenue added into the budget. Even I would be uncomfortable with these cut levels, and that’s saying something because it takes a lot to make me uncomfortable.

You and I have been preaching efficiency in government for years, and still will, but efficiency becomes effectively impossible if you don’t have sufficient resources to perform basic functions.

That is the position many agencies

would find themselves in if cuts are too deep. Cuts to core services will be untenable and take years to recover from if recurring revenues are not enacted this year. I am an optimist and I have to believe policymakers will rise to the challenge when they realize the alternative is to do real harm to real people.

#### Transportation bonds

**MILLER:** Perhaps this is a good time to say that use of one-time funds can be appropriate during times of extreme financial distress. I believe the Legislature will have no choice but to authorize transportation bonds to keep our infrastructure plan moving forward and free up money for current expenditures. It’s something we did when I served as House budget chair during the Great Recession. Roads and bridges are capital improvements – the

exact type of expenditures that bond issues are designed to finance.

Oklahoma is already a low-debt state, but \$350 million in bond debt will be retired in July 2018. Besides, the rating agencies should not look negatively at such responsible bond financing because of our current low debt and because it shows a commitment to maintaining the state’s infrastructure.

**DOERFLINGER:** I agree. Bonds are an appropriate way to fund large capital projects like roads and bridges that have useful lives of 20, 30, 40, and in some cases 50 or more years. Taking cash out of the operating budget to fund capital needs, like we do now, leaves less money available for state services like education, health and public safety. We are very cash-heavy in our approach to

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## Budget

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transportation funding and we need to move to more of a cash-bond mix.

I know some legislators have concerns that transportation bonds may build structural deficits into future budgets. Guess what? Lawmakers can fix structural deficits. They can cut spending, raise revenue, reprioritize existing resources or some mix of all those things to fix it. Fixing structural budget issues is within lawmakers' power to do, but what they can't fix are closed hospitals, shortened school weeks or prison riots – all of which could happen if revenue isn't freed up for this budget.

If it takes issuing bonds for capital projects so that schools and hospitals can keep their doors open, bonds are a no brainer.

**MILLER:** Well said.

### Tax reform

**MILLER:** I've been such a broken record on the need for tax reform and eliminating one-times that even I am tired of hearing myself talk about it. So I'm very appreciative of the governor's willingness to step out on this very tough issue that can correct our budget problems for the long term.

I believe that we can have a lower overall tax burden if the taxes are more broadly applied. In her State of the State address, the governor proposed sales tax reform and expanding the sales tax to some services.

It has never made sense to me that I go into a Starbucks to buy a \$10 cup of coffee and am required to pay sales tax on that purchase. But when I go next

door to get a haircut, there is no such tax. Both businesses have the same labor and rent costs, and the same technology to collect and report, but one is required to remit sales tax and the other is not.

Governor Frank Keating tried to reform the tax code to include services but failed. What is this governor's vision for tax reform?

**“If it takes issuing bonds for capital projects so that schools and hospitals can keep their doors open, bonds are a no brainer.”**

**DOERFLINGER:** The governor proposed a balanced tax reform approach that involves changes to credits and deductions as well as improving enforcement of existing collections. She has more than a dozen tax proposals, and only one – the cigarette tax adjustment – involves a rate increase. The rest are tax code reforms or tightening up existing tax laws. We think that's a far more palatable approach than outright tax increases. Her goal has been to be strategic instead of punitive.

One area she is very interested in that has not traditionally been explored is sales tax reform. Sales tax reform is a complex conversation, but it is finally occurring and hopefully will continue to for the foreseeable future. It's well past time to take a hard look at sales tax holistically and reconfigure it to match the 21<sup>st</sup> century economy, and I believe

policymakers are interested in doing that.

### Apportionment reform

**MILLER:** Over the years, numerous earmarks, or off-the-top money, have been placed into state law that siphon off money before it reaches the General Revenue Fund for the Legislature to appropriate. We see this each month when we compare the Gross Receipts to the Treasury report from my office with the General Revenue Fund report from your office.

I'd like to see more funds returned to General Revenue for the Legislature to appropriate. Of course, such a massive change is not likely because each earmark has a strong constituency – we all have those we would like to protect. But surely some modifications can be made and earmarks can be reexamined to see if adjustments are appropriate.

**DOERFLINGER:** The governor supports eliminating or modifying some of these earmarks to free up money for the operating budget. This is money government is already collecting that is going to noble purposes, but in many cases those purposes do not have needs as pressing as those of our schools, hospitals and other core services facing serious financial challenges.

The governor believes we have to ask what's more important: Putting new roofs on picnic pavilions at parks, or keeping schools and hospitals open?

### Education funding

**MILLER:** There are those who believe

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## Budget

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that education administrative costs are too high and not enough money is reaching the classroom. While true, an analysis of relative education spending across the country shows that even when adjusted for cost of living differences, Oklahoma is near the bottom in what we spend to educate our children. What some may call spending others may call investment. I believe we must invest more in education. Do you agree?

**DOERFLINGER:** Yes, money doesn't fix everything, but without money, what already needs fixing can break down entirely. That's what we need to avoid in the common education system. We can still debate how the money is used and whether our schools need broader systemic change, but the fact is that system needs money to stay functional. Our position this session is to avoid cuts to common education and restore the funding it lost midyear if at all possible.

There are needs in career technology and higher education, too, but they are not facing the challenges common education is facing. Now, professor, I know you're a strong supporter of the university system, but, in my opinion, higher education, in particular, has a lot more to do to become more efficient and eliminate waste. Higher education has made some operational efficiency advances lately, but it can do far more.

### Some cuts unavoidable

**MILLER:** Even if the revenue enhancements the governor is proposing are enacted, with such a large decrease in estimated revenue, cuts will still need to be made. My hope is that budget reductions to core services be kept as small as possible.

**DOERFLINGER:** When the hole is this big, cuts have to be made and are a major part of the approach. Almost every agency outside of our most critical services areas will see a cut.

The governor would like to see those cuts minimized wherever possible because most agencies have seen their appropriations reduced between 10 and 40 percent in the past decade.

“**Money doesn't fix everything, but without money, what already needs fixing can break down entirely.**”

### Wind power incentives

**MILLER:** I'll be honest, Preston, I don't like wind, especially this time of year. I do like the energy it produces, but I'm not much a fan of its overly generous incentives.

The state is obligated for hundreds of millions in wind incentives, but is getting zero dollars from the industry to pay for them. Is it enough for wind to brag about being incentive-free in 2020, or should they do more?

**DOERFLINGER:** Oil prices and structural budget problems are major challenges right now, but wind incentives are blowing a huge hole in the budget, too. These incentives have worked tremendously well and now they need to end.

Wind incentives are one of the biggest financial liabilities state government

faces today. These incentives will be huge handcuffs on our ability to climb out of the budget hole for years to come unless they get reined in now. It's a costly liability at a time we cannot afford it.

The taxpayers have helped stand this industry up and I believe they're now ready for it to stand on its own.

Once again, Ken, we have to ask what's more important: Subsidizing wind companies or keeping schools and hospitals open? I believe we will see necessary action this session to rein in these incentives.

**MILLER:** Clearly, there is consensus between the Secretary of Finance and the State Treasurer on these important issues. Hopefully, that will send a strong message on the need for extraordinary action during this budget crisis.

## Clarification

The graph Oklahoma Wind Generation vs. Natural Gas Price featured on page 1 of the March 2016 edition of the *Oklahoma Economic Report* was not meant to imply a direct causation between wind power generation and natural gas prices.

Instead, the chart presented two noteworthy data sets related to the story it accompanied.

While an argument can be made that natural gas-fueled generators and wind turbines are in competition, natural gas is a globally-traded commodity whose price is, of course, a function of many variables other than Oklahoma wind power generation.



## Gross Receipts & General Revenue compared

March Gross Receipts to the Treasury totalled \$940.4 million, while the General Revenue Fund (GRF), as reported by the Office of Management and Enterprise Services, received \$394.2 million, or 41.9% of the total.

The GRF received between 29.7% and 53.6% of monthly gross receipts during the past 12 months.

From March gross receipts, the GRF received:

- Personal income tax: 37.5%
- Corporate income tax: 56%
- Sales tax: 43.8%
- Gross production-Gas: 49.3%
- Gross production-Oil: 5.3%
- Motor vehicle tax: 26.9%
- Other sources: 48%

March GRF allocations are above the estimate by \$3.1 million or 0.8%. Fiscal year-to-date collections are less than the estimate by \$323.8 million or 8%.

March insurance premium taxes totaled \$19.01 million, a decrease of \$6.43 million, or 25.3%, from the prior year.

Tribal gaming fees generated \$11.06 million during the month, up by \$882,285, or 8.7%, from last March.

## Continued slide seen in March Gross Receipts to the Treasury

March Gross Receipts to the Treasury are the lowest March total in four years, State Treasurer Ken Miller announced.

March receipts of \$940.4 million are less than March of last year by almost \$17 million, or 1.8 percent. It marked an 11th consecutive month of falling collections.

At \$11.4 billion, 12-month Gross Receipts to the Treasury are the lowest since October 2013. Receipts shrank by \$679 million, or 5.6 percent, compared to the prior 12-month period.

“This month’s numbers show the contraction is ongoing and will likely

continue in the near term,” Miller said. “However, we’ve seen this cycle before and know Oklahoma will recover – hopefully having learned lessons on how to better weather the storm the next time.”

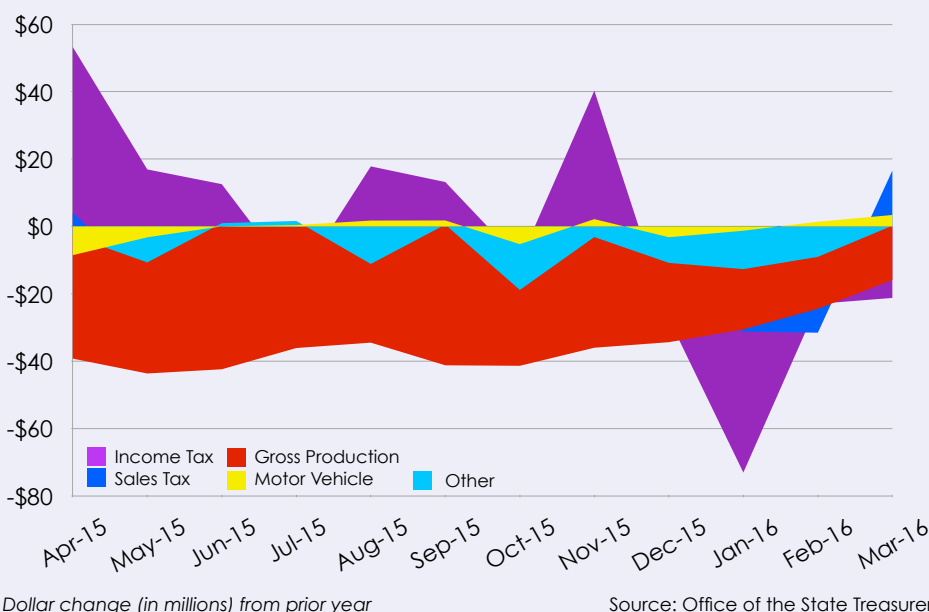
**“This month’s numbers show the contraction is ongoing and will likely continue in the near term.”**

Monthly collections from oil and natural gas production taxes have been lower than the same month of the prior year for 15 consecutive months. March gross production collections are more than 40

percent lower than last March. Monthly receipts are based on oil field activity from January when the average price of benchmark West Texas Intermediate

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### Monthly Gross Receipts vs. Prior Year





## Revenue

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crude oil was \$31.68 per barrel. Average oil prices were below that level in February, but recovered slightly in March.

Total March collections also show contraction in income tax revenues, but slight increases in sales and motor

vehicle tax receipts. For the 12-month report, all revenue streams are smaller than one year ago.

### Other indicators

The Oklahoma's Business Conditions Index remained below growth neutral for an 11th consecutive month.

However, the index from a monthly survey of supply managers rose to 49.7 in March from 39.4 in February. Numbers below 50 indicate economic contraction is expected during the next three to six month.

### About Gross Receipts to the Treasury

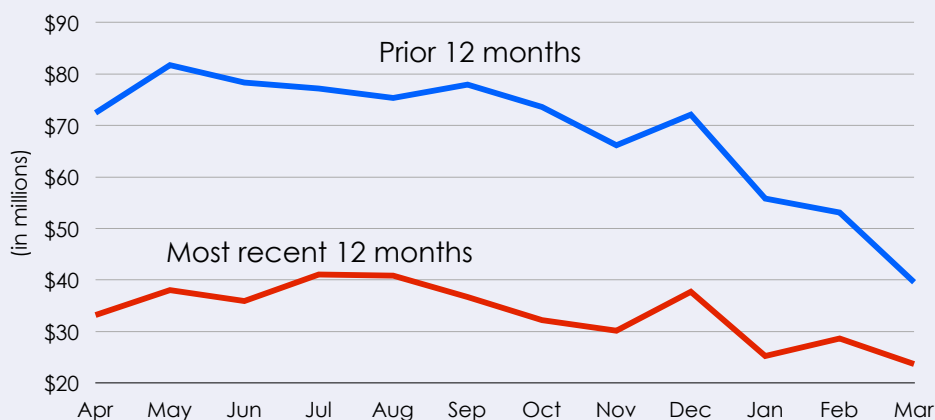
Since March 2011, the Treasurer's Office has issued the monthly Gross Receipts to the Treasury report, which provides a timely and broad view of the state's macro economy.

It is provided in conjunction with the General Revenue Fund (GRF) allocation report from the Office of Management and Enterprise Services, which provides important information to state agencies for budgetary planning purposes.

The GRF receives just less than half of the state's gross receipts with the remainder paid in rebates and refunds, remitted to cities and counties, and placed into other state funds.

### Gross Production Tax Collections

April 2014 – March 2016



Source: Oklahoma Tax Commission

## State unemployment rises to 4.4 percent in March

Oklahoma's seasonally-adjusted unemployment rate was set at 4.4 percent in March, up by two-tenths of a percentage point from February, according to the Oklahoma Employment Security Commission (OESC).

In March, statewide employment rose by 3,816 and unemployment rose by 3,939. Over the year, seasonally-adjusted unemployment grew by 3,836.

The national unemployment rate was set at 5 percent in March.

### Oklahoma Unemployment Report

March 2016

OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
Mar '16	4.4%	1,869,890	1,788,145	81,745
Feb '16	4.2%	1,862,135	1,784,329	77,806
Jan '16	4.1%	1,853,975	1,778,448	75,527
Dec '15	4.1%	1,847,602	1,771,229	76,373
Nov '15	4.1%	1,846,833	1,770,218	76,615
Oct '15	4.2%	1,845,974	1,768,887	77,087
Mar '15	4.2%	1,835,337	1,757,428	77,909

\* Data adjusted for seasonal factors

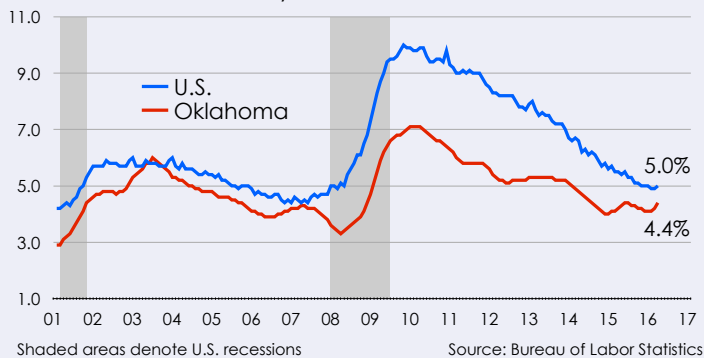
Source: OESC



## Economic Indicators

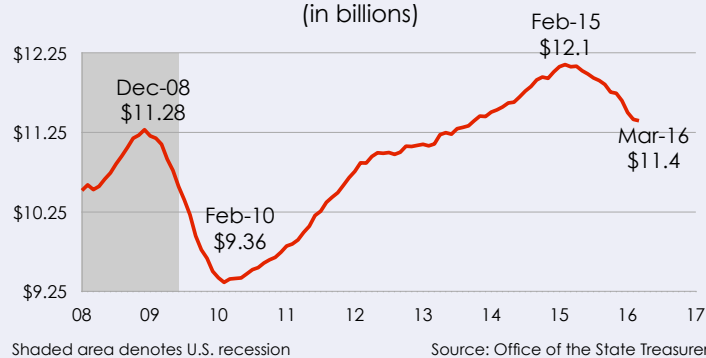
### Unemployment Rate

January 2001 – March 2016



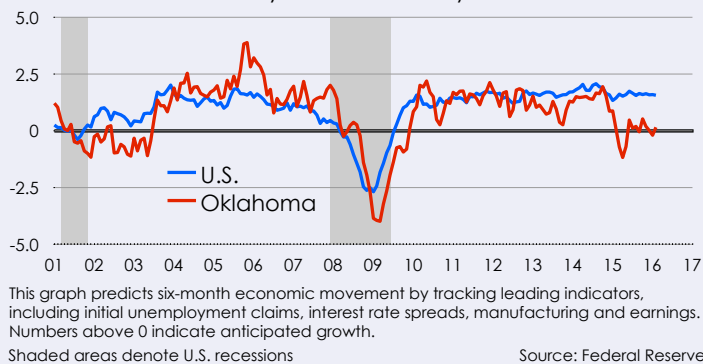
### Oklahoma 12-Month Gross Receipts

January 2008 – March 2016  
(in billions)



### Leading Economic Index

January 2001 – February 2016



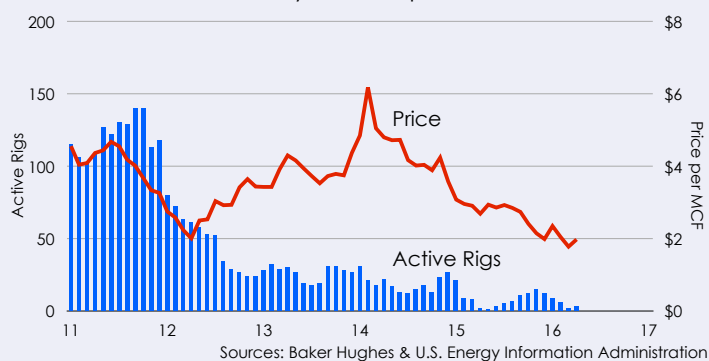
### Oklahoma Stock Index

Top capitalized companies  
January 2009 – April 2016



### Oklahoma Natural Gas Prices & Active Rigs

January 2011 – April 2016



### Oklahoma Oil Prices & Active Rigs

January 2011 – April 2016

